Small Cap Compass

Little Emperor Syndrome: Key driver of China’s consumption

Little Emperor Syndrome driving consumption in China

The Chinese government’s one-child policy has given rise to the Little Emperor Syndrome, a phenomenon in which only children receive excessive amounts of attention from their parents and grandparents. Notably, the so-called little emperors have emerged as major drivers of consumption. And once grown-up, they tend to prefer name-brand, high-quality, environmentally-friendly, and healthy products.

As members of the initial wave of little emperors start families of their own, we are seeing them devote even more attention to their children than their parents did. And working-class parents are also pouring all of their resources into their children. Most notably, the Little Emperor Syndrome is leading to the growth of the baby product market.

Opportunities for Korean firms

Little Emperor Syndrome should present opportunities to Korean firms in light of: Chinese consumers’ increasing preference for name brands, Korean products’ solid reputation, growing distrust of Chinese products, the government’s willingness to nurture the middle class, the easing of family-planning measures, and concerns related to Japanese nuclear leaks. And while the proportion of babies (infants and toddlers) in China’s overall population is actually shrinking, we see strong upside for baby products and services. Our optimism is based on: 1) the continued growth of the baby product/services market in developed nations despite low fertility rates and 2) Chinese income expansion.

Gaining a foothold in Chinese retail channels is becoming more difficult

Grown-up little emperors are quickly moving toward rational consumption. This trend is dragging down the margins of Chinese retailers, which are becoming pickier as a result. As such, we believe that the success of Korean firms in China will hinge on whether or not they can successfully access retail networks (rather than on demand).

Take note of Lock & Lock, Biospace, Kleannara, Maeil Dairy, and Zero to Seven

We expect Little Emperor Syndrome to benefit Lock & Lock (115390 KS/Not Rated), as the company already has a strong retail network in China. And demand for access to this network is likely to grow, boosting the company’s corporate value. Meanwhile, with young Chinese consumers increasingly becoming health-conscious, demand for Biospace’s (041830 KQ/Not Rated) InBody body composition analyzers will likely grow.

Also, Kleannara (004540 KS/Not Rated; diapers), Maeil Dairy (005990 KQ/Buy; infant formula), and Zero to Seven (159580 KQ/Not Rated; baby clothing) are aggressively attempting to penetrate China. Given that Chinese demand for Korean baby products is growing, we advise investors to pay attention to these companies.
## CONTENTS

Little Emperor Syndrome: Key driver of China’s consumption 3  
1. Five key factors 3  
2. Trends driven by young migrant workers 5  
3. Implications for Korean companies: Opportunities > risks 6  
4. Emergence of the baby product industry 10  
5. Conclusion: Sales channels hold the key 13  

Noteworthy stocks 14  
Lock & Lock (115390 KS) 15  
Biospace (041830 KQ) 25  
Kleannara (004540 KS) 30  
Maeil Dairy (005990 KQ) 35  
Zero to Seven (159580 KQ) 38
Little Emperor Syndrome: Key driver of China’s consumption

1. Five key factors

China’s little emperors were born after 1979 under China’s one-child policy. Because they grew up in material affluence, their consumption patterns tend to differ from those of earlier generations. In particular, those born in the 1980s and 1990s have emerged as key drivers of Chinese consumption.

Little emperors in their twenties and thirties value their personal lives and tend to be more open-minded than previous generations. According to statistical data, they account for approximately 26% of the overall population in China (200mn for those born in the 1980s; 140mn for those born in the 1990s). Those born in the 1980s tend to look for high-quality, environmentally-friendly, and healthy products. And those born in the 1990s are not hesitant to try new brands and purchase products online.

Chinese consumers, many of which had been ostentatious in their spending during the early stages of their country’s drive toward state capitalism, are now moving toward rational consumption. And this trend is being driven by the younger generation. In our view, Little Emperor Syndrome is characterized by the following five factors.

**Figure 1. Five key factors for China’s little emperor-driven consumer market**
Brands: With consumers shifting their focus from extravagance to personal satisfaction, demand for specialized brands is growing in China.

Category killers: Material affluence enabled the rise of large discount stores. However, rational consumers are now turning toward specialized retail channels, due in large part to strong demand for specific brands.

Wellness and leisure/sporting goods: Consumers are increasingly becoming health-conscious. And they are putting a stronger focus on quality of life. As a result, the leisure and sporting goods markets are displaying growth.

Baby products: Although it seems somewhat unintuitive, China’s baby product market actually began to expand following the implementation of the one-child policy. With individuals born in the 1980s getting married and giving birth, the market’s expansion has accelerated. We expect this trend to continue over the long term.

Online shopping malls: Younger Chinese consumers are not hesitant to shop or pay online. China’s first online shopping website came into being in 1997. After experiencing a slowdown in the early 2000s, the online shopping business expanded later in the decade. According to Tech in Asia, the Chinese online shopping market is estimated to have grown from US$74bn in 2010 to US$296bn in 2013, on the back of strong consumption by grown-up little emperors.

Figure 2. China’s baby product market

Source: China Commodity Professional Committee, KDB Daewoo Securities Research
2. Trends driven by young migrant workers

In addition to the five factors highlighted above, we also think it is worthwhile to take note of trends among young migrant workers born in 1980 and afterward. In China, migrant workers are non-agricultural workers who have moved from rural areas to big cities. They tend to be marginalized, especially by the country’s residency permit system, which ties each citizen’s social welfare benefits to his or her official place of residence. As of 2011, the number of young migrant workers in China was estimated at 100mn.

First, young migrant workers’ wages are low relative to the cost of living and home prices in the cities in which they work. In line with steep rises in urban housing costs in China, they have moved deeper into the suburbs over the past several years. As such, young migrant workers are spending increasing amounts of time on buses and/or subways.

Longer commutes have increased the use of 3G mobile phones and sparked growth in mobile commerce. According to LG Economic Research Institute, total mobile shopping revenue in China has reached RMB60bn, about one-third of the US figure and 6.4 times larger than Korea’s level. In addition, the country’s mobile shopping revenue grew at a CAGR of 488.7% during 2011-2012, sharply outpacing growth in the US (81%) and Korea (183%).

Second, young migrant workers are also famous for their “education fever,” as they want their children to have access to greater opportunities. Given that this mindset is common among the broader younger generation, the markets for premium baby products and education services have the potential to maintain long-term growth.

Figure 3. OP margins of Chinese retailers over the past three years

Source: Bloomberg, KDB Daewoo Securities Research
3. Implications for Korean companies: Opportunities > risks

We believe changes in Chinese consumption will present opportunities to Korean companies for the following reasons:

First, little emperors’ preference for name-brand products is driven by their: 1) desire for quality products, 2) preference for items that can meet specific needs, and 3) eagerness to express their individual identities. With this in mind, we believe that, going forward, a large number of brands are likely to compete in China using a variety of strategies (vs. an oligopoly). Accordingly, Korean brands boasting unique marketing and stronger product quality are likely to fare well in the country.

Second, Chinese consumers generally hold Korean products in high esteem, showing strong confidence in their quality and safety.

Third, many Chinese consumers distrust the products manufactured in their own country—food items in particular. The local population has not yet regained trust in Chinese powdered milk (formula) and dairy products after the melamine contamination scandal in 2008. Currently, foreign brands claim about 70% of the country’s powdered milk market (worth W9tr).

Fourth, the Chinese government is expected to implement various measures to expand the country’s middle-income bracket.

Fifth, China is easing its one-child policy by allowing families to have two children if at least one parent is from a one-child family. Bank of America expects around 9.5mn additional babies to be born (estimate of 16.05mn newborn babies in 2012) as a result of the revision. However, it should be noted that there are also more conservative estimates. Zero to Seven forecasts the relaxed one-child policy will boost the baby product market by just 10%, as the cost of raising children is already high in big cities. In smaller cities, however, costs still have significant upside, in our view.

Sixth, growing resistance to Japanese products after the Fukushima Daiichi nuclear disaster is giving rise to increased demand for Korean products as alternatives.

Figure 4. Demographics of major Asian countries

Source: UN, KDB Daewoo Securities Research

Figure 5. Laos’ demographics by age group

Source: UN, KDB Daewoo Securities Research
However, changes in China are also posing risks.

First, the Chinese population is rapidly aging. Although the recent relaxation of the one-child policy should slow down the pace of aging to an extent, it should fall short of reversing the trend. Accordingly, industries that cater to the needs of the elderly are expected to grow over the long term, weighing down baby- and children-related industries.

However, in our view, population aging is unlikely to pose an imminent threat. In Korea and developed countries in which population aging has progressed further than in China, markets baby product markets are still maintaining steady growth.
Figure 10. Income disparity in China

Source: CEIC, KDB Daewoo Securities Research

Figure 11. Wage trends in China

Source: CEIC, KDB Daewoo Securities Research

Figure 12. Breakdown of Chinese employment by industry type

Source: 2012 China Statistical Yearbook, KDB Daewoo Securities Research
Second, the income gap between the rich and the poor is widening in China. Most Korean products are aimed at customers practicing rational consumption, rather than conspicuous spenders. Since the shift from conspicuous to rational consumption will likely move in tandem with the rise of the middle class, it is important for investors to keep an eye on the Chinese government’s efforts to expand the middle-income bracket.

Third, retail margins are being squeezed. Chinese retailers are subject to heavy price-cutting pressure. However, the expansion of the Chinese market is likely to be sufficient to offset the margin squeeze.

In conclusion, given the high quality and superior designs of Korean products, we believe that opportunities for Korean companies are abundant, while risks are limited. Of note, it is essential for Korean firms to secure quality distribution channels.

**Figure 13. Breakdown of Korean employment by industry type**

**Figure 14. SWOT analysis of Korean products in the Chinese market**

Source: National Statistical Office, KDB Daewoo Securities Research

Source: KDB Daewoo Securities Research
4. Emergence of the baby product industry

The baby product industry is considered the hottest industry in the Chinese consumer market. In a report published by the Korea Trade-Investment Promotion Agency (KOTRA), an employee at the Shinsegae department store in Beijing was cited as saying that baby product sales were rising by more than 25% despite high prices.

1) Chinese powdered milk market

According to market research, the Chinese powdered milk market will expand to US$25bn (W27tr) in 2017. The market is currently dominated by foreign brands, which account for 70% of its size. It should be noted that the market share of foreign brands fell modestly in August, as a product imported from New Zealand was found to be contaminated with bacteria that could cause botulism. However, by and large, Chinese consumers still prefer foreign brands.

As of end-2012, Korea ranked sixth among China’s milk importers, trailing Germany, New Zealand, Australia, France, and the US. Given that Korean milk products are displaying robust sales in some cities, we believe that Korean makers are likely to seek to increase Chinese exports through sales channel expansion.

Korean powdered milk brands currently account for a mere 0.2% of the Chinese market. However, Korean products sell at high prices in China, as local consumers think that they: 1) are superior in terms of food safety; 2) suit the physical constitution of Chinese infants; and 3) are packaged in convenient containers.

Figure 15. Chinese baby product market

Source: China Commodity Professional Committee; KDB Daewoo Securities Research
### Table 1. Prices of infant formula brands distributed in China (RMB)

<table>
<thead>
<tr>
<th>Brand</th>
<th>Packaging</th>
<th>Country</th>
<th>Market price</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absolute (金典名作)</td>
<td></td>
<td>Korea</td>
<td>288</td>
<td>800g</td>
</tr>
<tr>
<td>Baolekang (宝乐康)</td>
<td></td>
<td>Korea</td>
<td>288</td>
<td>750g</td>
</tr>
<tr>
<td>Imperial (林則兒)</td>
<td></td>
<td>Korea</td>
<td>238</td>
<td>800g</td>
</tr>
<tr>
<td>Emfamil (美赞臣)</td>
<td></td>
<td>US</td>
<td>215</td>
<td>900g</td>
</tr>
<tr>
<td>Meiji (明治)</td>
<td></td>
<td>Japan</td>
<td>188</td>
<td>850g</td>
</tr>
<tr>
<td>Friso (美素力)</td>
<td></td>
<td>US</td>
<td>165</td>
<td>900g</td>
</tr>
<tr>
<td>Wyeth (惠氏)</td>
<td></td>
<td>US</td>
<td>165</td>
<td>900g</td>
</tr>
<tr>
<td>Nestle (雀巢)</td>
<td></td>
<td>Switzerland/China (joint venture)</td>
<td>130</td>
<td>900g</td>
</tr>
<tr>
<td>Wanda Mountain (完达山)</td>
<td></td>
<td>China</td>
<td>100</td>
<td>900g</td>
</tr>
<tr>
<td>Guangming (光明)</td>
<td></td>
<td>China</td>
<td>85</td>
<td>900g</td>
</tr>
</tbody>
</table>

Source: KOTRA, KDB Daewoo Securities Research

### Figure 16. Korea’s powdered milk exports to China

![Korea's powdered milk exports to China](image)

Source: KOTRA, KDB Daewoo Securities Research
2) Chinese diaper market

In China, consumption by the only sons and daughters born under the one-child policy (introduced in 1979) in the 1980s and 1990s is on the rise. Furthermore, given that the Chinese government has recently eased its family planning policy to offset population aging, the Chinese baby product market will likely grow rapidly.

In particular, the Chinese diaper market is expected to expand sharply, given that: 1) 20-30mn babies are born in China annually; and 2) the number of under-36-month-old babies stands at 40-50mn.

Until the early 2000s, Chinese people mostly used cloth diapers, with the penetration of disposable diapers hovering around only 2%. Currently, however, the penetration of disposable diapers is estimated at around 30%, and the figure is projected to climb to around 60% in 2020. In 2007-10, the CAGR of Chinese disposable diaper consumption was 30%. In 2011, Chinese diaper sales reached about RMB24.3bn (W4.2tr), while diaper imports increased by 17% YoY to US$183mn—of which imports from Korea contributed US$91mn (+5% YoY).

The Chinese diaper market is dominated by seven foreign premium brands, including Procter & Gamble’s Pampers (US), Yuhan-Kimberly’s Huggies (Korea), and Kao’s Merries (Japan). Local brands are unpopular among Chinese consumers due to their poor quality. Of note, demand for Japanese brands is falling gradually on safety concerns arising from Japan’s nuclear leakage issue; this trend is likely to benefit Korean brands.

Table 2. Chinese disposable diaper market (mn persons, bn packages, %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Babies aged two years old and younger</th>
<th>Consumption</th>
<th>Usage %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>41</td>
<td>7.8</td>
<td>17.6</td>
</tr>
<tr>
<td>2008</td>
<td>41</td>
<td>9.6</td>
<td>21.1</td>
</tr>
<tr>
<td>2010</td>
<td>43</td>
<td>13.8</td>
<td>29.6</td>
</tr>
<tr>
<td>2020F</td>
<td>45</td>
<td>29.8</td>
<td>60.1</td>
</tr>
</tbody>
</table>

Source: KOTRA, KDB Daewoo Securities Research

Figure 17. China’s diaper imports

Source: KOTRA, KDB Daewoo Securities Research
5. Conclusion: Sales channels hold the key

The new consumer market created by China’s little emperors will definitely offer opportunities to Korean makers. We believe that companies’ ability to seize these opportunities will largely hinge on sales channel expansion. With this in mind, we believe that Korean companies that have recently secured sales channels (Lock & Lock) and those that are currently doing so (Maeil Dairy, Zero to Seven, Kleannara, Agabang & Company, Boryung Medience, and Samchuly Bicycle) still have significant room for growth in the Chinese market.

For Lock & Lock (115390 KS), its role as a retailer in the Chinese market deserves attention. Furthermore, heightened health consciousness among younger Chinese will likely accelerate the sales growth of Biospace’s (941830 KQ) body composition analyzer.

In addition, Kleannara’s (004540 KS) diapers, Maeil Dairy’s (005990 KQ) powdered milk formula, and Zero to Seven’s (159580 KS) baby products could make splashes in the Chinese market. Given the robust demand for Korean baby products, we advise investors to keep a close eye on the performances of these companies.

Table 3. Additional beneficiaries of changing consumption trends in China

<table>
<thead>
<tr>
<th>Sector</th>
<th>Company</th>
<th>Ticker</th>
<th>Major businesses/Chinese market expansion details</th>
</tr>
</thead>
</table>
| Health/healthcare     | Boryung Medience         | 014100 KQ | - Skin care-oriented baby product lineup  
- Weak profitability due to intense competition in the domestic market and royalty-oriented revenue structure  
- Established a subsidiary in Tianjin for direct exports to China  
- The brand B&B is growing increasingly popular in online shopping malls; likely to advance into a Chinese department store soon  
- Plans to improve profitability by removing underperforming royalty brands from its product lineup |
| Fashion/apparel       | Agabang & Company        | 013990 KQ | - A pioneer of Korea’s baby product market  
- Revenue has been stagnant amid intense competition; plans to find a breakthrough via overseas expansion or new businesses  
- Discontinued the brand Basic Elle, which posted losses of W4bn in 2012 and 2013  
- Sells Agabang brand products mainly via a sales subsidiary in Yantai; low brand awareness  
- Plans to set up a subsidiary in Shanghai |
| Education              | Samick Music             | 002450 KS | - Korea’s largest musical instrument manufacturer  
- Piano sales account for more than 50%; controls 30-35% of the domestic piano market  
- Expectations of increased piano sales in China is rising  
- Chinese revenue to rise from W28bn in 2012 to W35bn in 2013 and W40bn in 2014 |
| Leisure/sports        | Samchuly Bicycle         | 024950 KQ | - Controls 40% of the Korean bicycle market; holds a wide-ranging bicycle lineup  
- Very Good Leisure, in which Samchuly holds a 38% stake, sells premium bicycles  
- Sold about 10,000 electric bicycles in 2013  
- Electric bicycle exports to China to expand rapidly |
Noteworthy stocks

Lock & Lock (115390 KS/Not Rated) In possession of a strong retail network in China
- Company’s broader competitiveness likely to gain traction
- New baby product brand to perform well in light of proven brand management and marketing
- Likely to play a role as a retailer in China over the long term

Biospace (041830 KQ/Not Rated) War against obesity extending to China
- No. 1 global supplier of body composition analyzers
- 3Q review: Earnings defy slow season thanks to InBody exports
- Undervalued compared to medical device peers

Kleannara (004540 KS/Not Rated) Bullish on China, but overhang risk remains
- The only home-grown comprehensive paper product supplier
- Personal care exports to boost earnings
- Optimistic on earnings growth but overhang risk remains

Maeil Dairy (005990 KQ/Buy) China holds the key
- Pace of powdered milk growth in China will be key
- Milk price hikes and expansion into coffee and cheese
- Maintain Buy and TP of W50,000

Zero to Seven (159580 KQ/Not Rated) A long-term growth play
- Leading children’s wear maker with high overseas growth potential
- Long-term catalysts: Growth of China’s children’s product market
- Weak 2013 earnings expected, but ample room for long-term growth still exists
Lock & Lock
(115390 KS)

In possession of a strong retail network in China

Focus on broader competitiveness, not just on product quality

Lock & Lock has found success in the Chinese airtight food container market on the back of its strong brand reputation and premium pricing policy. However, this year, the company’s earnings have disappointed significantly, denting its prospects for growth. Demand in emerging markets (e.g., Southeast Asia) still seems insufficient to offset tepid demand from developed nations and a slowdown in Chinese demand growth.

However, we expect Lock & Lock to lift off again with the launch of its Hello, Bebe brand. We are optimistic about this new business, in light of the robust growth of the Chinese baby product market. Further, this expansion marks Lock & Lock’s entry into consumables. (The company’s flagship food containers are durable goods).

Taking into account the company’s brand management and marketing capabilities, and Chinese consumers’ preference for overseas baby products, we expect the Hello, Bebe brand to perform well. Most importantly, with large discount stores suffering margin deterioration, overseas firms are finding it difficult to secure retail channels in China. As such, we believe that the company will reinforce its role as a retailer in China for local and overseas firms.

2014 will be an important year for Lock & Lock. The company’s airtight food container unit aims to assure investors by delivering revenue growth and margin improvement. And the Hello, Bebe brand also needs to show stable performance. If both units are able to fare well, the company’s corporate value should soar.

Peer valuation analysis

With the launch of the Hello, Bebe brand, Lock & Lock is now engaging in three businesses: airtight food containers, retailing, and baby products. After comparing the three businesses with their respective peer groups, we believe that the company’s P/B is relatively low, while its P/E is relatively high.

Lock & Lock’s valuation has already exceeded that of its food container peers, and is starting to follow the valuations of Chinese baby product and household goods companies. We advise investors to keep tabs on whether or not the company is able to meet market expectations.
Focus on broader competitiveness, not just on product quality

1. Strong brand reputation, but dented growth prospects

Lock & Lock has found success in the Chinese airtight food container market on the back of its strong brand reputation and premium pricing policy. Notably, thanks to its commitment to premium pricing, Chinese operations have contributed 70% of the company’s overall operating profit in 2012, vs. 50% for revenue.

However, Lock & Lock’s 2013 earnings have been disappointing. In 1Q13, parent-based earnings plunged 30% YoY due to sluggish home shopping sales. Chinese revenue, which soared by more than 20% YoY in 2012, inched up 1.8% YoY in 1Q and 14.4% YoY in 2Q, but declined by 1.5% YoY in 3Q.

Sluggish Chinese revenue in 3Q was largely due to the government’s reinforcement of its crackdown on bribery. However, many investors still do not appear optimistic about the airtight food container business in China. The number of glass container competitors to Lock & Lock increased from 3-4 in 2012 to 18 this year. And with consumers increasingly turning to rational consumption, many doubt that the company’s premium pricing strategy will continue to work.

Demand from Southeast Asia is growing, but it is still insufficient to offset tepid demand from existing markets. For Southeast Asian operations, the proportion of B2B sales is still high, and revenue contribution by channel remains unchanged. We think that Southeast Asia will act as a production base rather than a market for the time being.

Figure 1. Premium pricing of Lock & Lock

Table 1. Revenue breakdown by channel (China)

<table>
<thead>
<tr>
<th>Channel</th>
<th>1Q11</th>
<th>2Q11</th>
<th>3Q11</th>
<th>4Q11</th>
<th>1Q12</th>
<th>2Q12</th>
<th>3Q12</th>
<th>4Q12</th>
<th>1Q13</th>
<th>2Q13</th>
<th>3Q13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home shopping</td>
<td>17%</td>
<td>22%</td>
<td>22%</td>
<td>20%</td>
<td>23%</td>
<td>23%</td>
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<td>24%</td>
<td>23%</td>
<td>21%</td>
<td>21%</td>
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<tr>
<td>B2B</td>
<td>33%</td>
<td>29%</td>
<td>22%</td>
<td>20%</td>
<td>22%</td>
<td>24%</td>
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<td>16%</td>
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<td>Wholesale</td>
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<td>Mono-brand shops</td>
<td>11%</td>
<td>10%</td>
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<td>8%</td>
<td>10%</td>
<td>11%</td>
<td>8%</td>
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Source: AlphaWise, Morgan Stanley, company data, KDB Daewoo Securities Research
Table 2. Revenue breakdown by channel (Southeast Asia)

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<tr>
<th></th>
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<td>B2B</td>
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<td>41%</td>
<td>40%</td>
<td>47%</td>
<td>33%</td>
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<td>33%</td>
<td>51%</td>
<td>41%</td>
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<tr>
<td>Home shopping</td>
<td>6%</td>
<td>1%</td>
<td>3%</td>
<td>4%</td>
<td>4%</td>
<td>5%</td>
<td>8%</td>
<td>3%</td>
<td>2%</td>
<td>4%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Company data, KDB Daewoo Securities Research

2. Focus on broader competitiveness

The indisputable quality of Lock & Lock's food containers enabled the company to become a global market leader. However, we think the company has other strong competitiveness factors: brand management, marketing know-how, and retail networks.

The limitations facing Lock & Lock are as follows:

1) Since airtight food containers are highly durable, upside for demand is limited. As such, sustaining and expanding growth could prove challenging for Lock & Lock. Indeed, the company's expansion into food containers designed for use during outdoor activities was part of its efforts to overcome these limitations.

2) Lock & Lock is cemented in the minds of consumers as a food container maker; in our view, this has hampered the company's lineup expansion efforts. Indeed, the company's non-container kitchen products have not made any meaningful contributions to revenue. Furthermore, popular Korean products (e.g., Cheong Kwan Jang red ginseng, Cuckoo rice cookers) did not sell well in Lock & Lock stores in China, indicating the company's limited corporate image.

3. Launch of the Hello, Bebe brand

In launching Hello, Bebe, Lock & Lock decided to develop new distribution channels, as the company was concerned that its brand image was too closely tied to food containers.

However, the company's brand management, marketing, and distribution channel development capabilities should help the new brand swiftly take root in China. In addition, its track record of success is boosting expectations for the company's ventures in the baby product market.

In addition to the overall positive outlook for China's baby product market, Hello, Bebe's product portfolio is also noteworthy. Among the brand's three major items (i.e., bottles, diapers, and powdered milk), two are non-durable necessities.

In light of Chinese consumers' preference for foreign brands, recent difficulties in China's retail environment, and Korean companies' desire to enter the Chinese market, Lock & Lock also holds value as a distribution platform. If the company achieve meaningful sales growth with the Hello, Bebe brand, demand for access to its distribution network should continue to grow.
Earnings and forecasts

In forecasting earnings for Lock & Lock’s existing and new businesses, we took a conservative approach. We will revisit our forecasts when uncertainties are reduced following the company’s 4Q earnings announcement.

1. Existing business (Lock & Lock)

We expect the company to report 4Q revenue of W128.8bn (+1.5% QoQ, +8.2% YoY), with parent revenue of W43.5bn (+12.4% YoY). By region, revenue from China is projected at W68.8bn (+16.6% YoY), Southeast Asia at W11.3bn (-19.6% YoY), and other markets at W22.8bn (-70% YoY). 2013 consolidated annual revenue is anticipated to inch down YoY to W504.2bn from W508.4bn. Operating profit is forecast to improve 3.0% YoY to W76.7bn on a consolidated basis.

Table 3. Revenue estimates by region (Wbn, %)

<table>
<thead>
<tr>
<th></th>
<th>1Q12</th>
<th>2Q12</th>
<th>3Q12</th>
<th>4Q12</th>
<th>2012F</th>
<th>1Q13F</th>
<th>2Q13F</th>
<th>3Q13F</th>
<th>4Q13F</th>
<th>2013F</th>
<th>2014F</th>
<th>2015F</th>
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</thead>
<tbody>
<tr>
<td>Revenue YoY growth</td>
<td>124</td>
<td>136</td>
<td>129</td>
<td>119</td>
<td>508</td>
<td>114</td>
<td>134</td>
<td>127</td>
<td>129</td>
<td>504</td>
<td>577</td>
<td>630</td>
</tr>
<tr>
<td>Headquarters Net revenue excluding exports YoY growth</td>
<td>37</td>
<td>46</td>
<td>39</td>
<td>34</td>
<td>156</td>
<td>26</td>
<td>32</td>
<td>35</td>
<td>30</td>
<td>123</td>
<td>111</td>
<td>100</td>
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<tr>
<td>Net revenue including exports YoY growth</td>
<td>39</td>
<td>46</td>
<td>40</td>
<td>39</td>
<td>164</td>
<td>35</td>
<td>47</td>
<td>48</td>
<td>44</td>
<td>173</td>
<td>159</td>
<td>147</td>
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<tr>
<td>Excluding exports/including exports</td>
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<td>9.9</td>
<td>9.8</td>
<td>8.9</td>
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<td>7.3</td>
<td>7.0</td>
<td>7.1</td>
<td>7.0</td>
<td>6.8</td>
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<td>China Net revenue including exports YoY growth</td>
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<td>69</td>
<td>59</td>
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<td>78</td>
<td>68</td>
<td>69</td>
<td>280</td>
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<td>Southeast Asia Net revenue excluding exports YoY growth</td>
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<td>6</td>
<td>6</td>
<td>10</td>
<td>29</td>
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<td>66</td>
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<tr>
<td>Net revenue including exports YoY growth</td>
<td>8.8</td>
<td>8.9</td>
<td>5.2</td>
<td>14.2</td>
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<td>37.0</td>
<td>5.0</td>
<td>15.5</td>
<td>75.0</td>
<td>13.0</td>
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<tr>
<td>Excluding exports/including exports</td>
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<td>15</td>
<td>14</td>
<td>14</td>
<td>55</td>
<td>10</td>
<td>8</td>
<td>10</td>
<td>11</td>
<td>38</td>
<td>73</td>
<td>94</td>
</tr>
<tr>
<td>Other Net revenue YoY growth</td>
<td>8</td>
<td>7</td>
<td>6</td>
<td>7</td>
<td>28</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>10</td>
<td>8</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: Company data, KDB Daewoo Securities Research

Table 4. Quarterly and annual revenue (Wbn, %)

<table>
<thead>
<tr>
<th></th>
<th>1Q12</th>
<th>2Q12</th>
<th>3Q12</th>
<th>4Q12</th>
<th>2012F</th>
<th>1Q13F</th>
<th>2Q13F</th>
<th>3Q13F</th>
<th>4Q13F</th>
<th>2013F</th>
<th>2014F</th>
<th>2015F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue YoY growth</td>
<td>124</td>
<td>136</td>
<td>129</td>
<td>119</td>
<td>508</td>
<td>114</td>
<td>134</td>
<td>127</td>
<td>129</td>
<td>504</td>
<td>577</td>
<td>630</td>
</tr>
<tr>
<td>COGS YoY growth</td>
<td>63</td>
<td>72</td>
<td>66</td>
<td>68</td>
<td>269</td>
<td>60</td>
<td>73</td>
<td>69</td>
<td>71</td>
<td>273</td>
<td>317</td>
<td>354</td>
</tr>
<tr>
<td>Gross profit Gross margin</td>
<td>610</td>
<td>61</td>
<td>64</td>
<td>63</td>
<td>51</td>
<td>239</td>
<td>54</td>
<td>61</td>
<td>57</td>
<td>231</td>
<td>260</td>
<td>260</td>
</tr>
<tr>
<td>SG&amp;A SG&amp;A-to-revenue ratio</td>
<td>39</td>
<td>42</td>
<td>43</td>
<td>40</td>
<td>165</td>
<td>34</td>
<td>38</td>
<td>40</td>
<td>42</td>
<td>154</td>
<td>180</td>
<td>194</td>
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<tr>
<td>Operating profit OP margin</td>
<td>21</td>
<td>20</td>
<td>21</td>
<td>12</td>
<td>74</td>
<td>20</td>
<td>24</td>
<td>17</td>
<td>16</td>
<td>77</td>
<td>80</td>
<td>82</td>
</tr>
</tbody>
</table>

Source: Company data, KDB Daewoo Securities Research
This year, Lock & Lock has started to recognize exports to North America and Europe (produced in China and Vietnam) as parent revenue. Excluding exports, parent revenue growth was -29.0% YoY in 1Q and -30.7% YoY in 2Q. Including exports, parent revenue growth was -8.9% YoY in 1Q and 0.8% YoY in 2Q. In our view, however, this accounting change is negative to the company, as it gives the impression that the company’s domestic operations are struggling.

It is also unclear what percentage of production volume in China and Southeast Asia is recognized at the parent level. Indeed, the company does not reveal detailed figures on Chinese operations. In Southeast Asia, revenue excluding exports came in at W6.3bn in 3Q12 and W9.7bn in 4Q12, while revenue including exports came in at W14.3bn in 3Q12 and W14bn in 4Q12. As revenue that had been booked as direct exports by overseas subsidiaries is now booked as parent revenue, these two revenue metrics should no longer differ significantly.

At domestic operations, the gap between revenue including and excluding exports was W1bn in 3Q12 and W4.4bn in 4Q12. The gap widened to W8.9bn in 1Q13 and W15bn in 2Q13. Meanwhile, in Southeast Asia, the gap has narrowed from W7.3bn in 3Q12 and W4.3bn in 4Q12 to W2.3bn in 1Q13 and W0.6bn in 2Q13. Thus, exports from Southeast Asia appear to account for just a marginal proportion of in the company’s parent revenue. Accordingly, we believe that weaker-than-expected growth in China has greatly contributed to the decline in annual parent revenue.

In forecasting 2014 earnings, we assumed that the company will return to its prior accounting methods. As a result, parent revenue is likely to swing to negative in 2014. Although parent revenue growth (excluding exports) is not expected to be as dismal as the -30% YoY figure recorded in 1H13, we believe that the company’s guidance of 2013–level growth is too optimistic. We forecast Lock & Lock’s parent revenue to decline 10% YoY each in 2014 and 2015, with revenue including exports sliding a bit more slowly. Due to low profitability, the company is anticipated to steadily reduce revenue in North America and Europe. Thus, the company will eventually stop recognizing exports from China and Southeast Asia to the regions at the parent level.

We expect Chinese revenue to increase by 10.9% YoY in 2014 and 4.9% in 2015. Meanwhile, we forecast Southeast Asian revenue to soar by 90.3% YoY in 2014 and 29.1% in 2015 on the back of: 1) an increase in the proportion of local production and 2) accounting changes (exports from overseas subsidiaries likely to be recognized as overseas revenue).

We project food container revenue, excluding Hello, Bebe revenue, to increase by 9.0% to W549.8bn in 2014 and by 4.2% to W573bn in 2015. Since the company’s revenue growth has slowed markedly in 2013, it would be inappropriate to make aggressive forecasts for 2014.

As such, we conservatively project operating profit (excluding the Hello, Bebe business) at W78.5bn (+9% YoY) in 2014 and W74.9 (+4.2% YoY) in 2015. We believe that there is only a little room for operating profit improvement at Lock & Lock’s existing food container business, given that: 1) the Chinese consumer market is rapidly shifting to rational consumption; and 2) competition is intensifying markedly in China.
2. Earnings forecasts for Hello, Bebe business

The earnings picture for Hello, Bebe remains cloudy. However, we were able to confirm that, as of 2Q13, the brand had already set up 1,842 display stands at major stores in 33 Chinese provinces. In addition, Bosomi diapers are set to be available for sale at RT-Mart, the largest discount store chain in China, and they are certain to advance into Lotus stores soon. For RT-Mart, Bosomi will gradually become available at its 118 stores. Therefore, it will take some time to get a clear picture of sales trends in China.

The company is currently waging a massive marketing campaign for Hello, Bebe. However, it is still too early to forecast earnings for the business with a high degree of certainty. Our baseline revenue forecasts for Hello, Bebe are W27bn in 2014 and W57bn in 2015. We believe the 2014 figure is on the conservative side in light of the number of baby product stores and large discount stores in which Hello, Bebe products will be available. The company plans to present earnings guidance for Hello, Bebe during its 4Q earnings announcement.

Table 5. Top hypermarkets in China (2011) (US$mn)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Logo</th>
<th>No. of stores</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>RT-Mart</td>
<td>185</td>
<td>980</td>
</tr>
<tr>
<td>2</td>
<td>Carrefour</td>
<td>203</td>
<td>700</td>
</tr>
<tr>
<td>3</td>
<td>Walmart</td>
<td>240</td>
<td>610</td>
</tr>
<tr>
<td>4</td>
<td>Vanguard</td>
<td>235</td>
<td>430</td>
</tr>
<tr>
<td>5</td>
<td>Century Mart</td>
<td>158</td>
<td>280</td>
</tr>
<tr>
<td>6</td>
<td>A.Best</td>
<td>120</td>
<td>270</td>
</tr>
<tr>
<td>7</td>
<td>Trust-Mart</td>
<td>112</td>
<td>260</td>
</tr>
<tr>
<td>8</td>
<td>My Mall</td>
<td>110</td>
<td>240</td>
</tr>
<tr>
<td>9</td>
<td>Yonghui</td>
<td>145</td>
<td>240</td>
</tr>
<tr>
<td>10</td>
<td>Renrenle</td>
<td>115</td>
<td>210</td>
</tr>
</tbody>
</table>

Source: KOTRA, KDB Daewoo Securities Research

Table 6. China’s distribution networks (no. of stores)

<table>
<thead>
<tr>
<th>Retail formats</th>
<th>4Q11</th>
<th>4Q12</th>
<th>1Q13</th>
<th>2Q13</th>
<th>3Q13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supermarkets and smaller</td>
<td>4,464</td>
<td>4,769</td>
<td>4,914</td>
<td>4,941</td>
<td>5,006</td>
</tr>
<tr>
<td>Wholesalers</td>
<td>138</td>
<td>196</td>
<td>168</td>
<td>166</td>
<td>168</td>
</tr>
<tr>
<td>Hypermarkets</td>
<td>1,426</td>
<td>1,563</td>
<td>1,597</td>
<td>1,617</td>
<td>1,632</td>
</tr>
<tr>
<td>Corporate customers</td>
<td>682</td>
<td>941</td>
<td>1107</td>
<td>1,016</td>
<td>973</td>
</tr>
<tr>
<td>Department stores</td>
<td>389</td>
<td>303</td>
<td>294</td>
<td>298</td>
<td>304</td>
</tr>
<tr>
<td>Mono-brand shops</td>
<td>95</td>
<td>92</td>
<td>86</td>
<td>85</td>
<td>71</td>
</tr>
<tr>
<td>Online</td>
<td>22</td>
<td>58</td>
<td>66</td>
<td>70</td>
<td>71</td>
</tr>
<tr>
<td>TV home shopping</td>
<td>22</td>
<td>20</td>
<td>21</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>Total</td>
<td>7,238</td>
<td>7,942</td>
<td>8,253</td>
<td>8,214</td>
<td>8,246</td>
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<tr>
<td>Baby product stores</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,842</td>
<td>1,842</td>
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</table>

Source: Company data, KDB Daewoo Securities Research
Peer valuation comparison

With the launch of the Hello, Bebe brand, Lock & Lock is now fully engaged in three business areas: airtight food containers, retailing, and baby products. In comparison with other food container makers, the company's P/B is currently low, while its P/E is very high. This indicates that the company is starting to exhibit differentiated share performance vs. its global peers.

Figure 2. Valuation comparison of Lock & Lock vs. airtight food container peers (1)

Source: Bloomberg, KDB Daewoo Securities Research

Figure 3. Valuation comparison of Lock & Lock vs. airtight food container peers (2)

Source: Bloomberg, KDB Daewoo Securities Research
Compared to its retail peers, the company’s P/B is in the middle of the pack, while its P/E is high. Of note, despite the high growth potential of the Chinese consumer market, Lock & Lock is the only member of its retail peer group with a 2014F P/E of more than 20x. In fact, it appears as though Lock & Lock's retail rivals are struggling at the front lines of the retail market (i.e., dealing with end consumers).

Figure 4. Valuation comparison of Lock & Lock vs. retail peers (1)

Figure 5. Valuation comparison of Lock & Lock vs. retail peers (2)
Compared to baby product/household goods peers, the company’s P/B is low, while its P/E is high. In this peer group, shares of companies that have delivered tangible results in the Chinese market are currently trading at high P/Es. In terms of valuations, Lock & Lock appears to be catching up with Chinese retailers, or baby product/household goods companies that have been faring well in the Chinese market. In order to see Lock & Lock outperform expectations in 2014, the company must be able to deliver solid growth at both existing and new businesses. If the company does so, its valuation will likely level up.

**Figure 6. Valuation comparison of Lock & Lock vs. baby product/household goods peers (1)**

Source: Bloomberg, KDB Daewoo Securities Research

**Figure 7. Valuation comparison of Lock & Lock vs. baby products/household goods peers (2)**

Source: Bloomberg, KDB Daewoo Securities Research
### Comprehensive Income Statement (Summarized)

<table>
<thead>
<tr>
<th>(Wbn)</th>
<th>12/12</th>
<th>12/13F</th>
<th>12/14F</th>
<th>12/15F</th>
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<tbody>
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<td>Revenue</td>
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<td>Cost of Sales</td>
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<td>231</td>
<td>260</td>
<td>276</td>
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<td>SG&amp;A Expenses</td>
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<td>Operating Profit (Adj)</td>
<td>72</td>
<td>77</td>
<td>80</td>
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<tr>
<td>Operating Profit</td>
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<tr>
<td>Non-Operating Profit</td>
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<td>-19</td>
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<td>Profit from Continuing Operations</td>
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<td>60</td>
<td>59</td>
<td>61</td>
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<tr>
<td>Profit from Discontinued Operations</td>
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<td>Non-Controlling Interests</td>
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<tr>
<td>Total Comprehensive Profit</td>
<td>36</td>
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<td>0</td>
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<td>EBITDA</td>
<td>96</td>
<td>101</td>
<td>105</td>
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<td>FCF (Free Cash Flow)</td>
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<td>62</td>
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<tr>
<td>EBITDA Margin (%)</td>
<td>19.0</td>
<td>20.1</td>
<td>18.2</td>
<td>17.1</td>
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<tr>
<td>Operating Profit Margin (%)</td>
<td>14.2</td>
<td>15.2</td>
<td>13.9</td>
<td>13.1</td>
</tr>
<tr>
<td>Net Profit Margin (%)</td>
<td>11.8</td>
<td>11.8</td>
<td>10.3</td>
<td>9.7</td>
</tr>
</tbody>
</table>

### Statement of Financial Condition (Summarized)

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<thead>
<tr>
<th>(Wbn)</th>
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<th>12/13F</th>
<th>12/14F</th>
<th>12/15F</th>
</tr>
</thead>
<tbody>
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<td>Current Assets</td>
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<td>571</td>
<td>660</td>
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<tr>
<td>Cash and Cash Equivalents</td>
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<td>258</td>
<td>327</td>
</tr>
<tr>
<td>AR &amp; Other Receivables</td>
<td>83</td>
<td>82</td>
<td>93</td>
<td>101</td>
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<tr>
<td>Inventories</td>
<td>108</td>
<td>107</td>
<td>122</td>
<td>133</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>18</td>
<td>18</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td>Non-Current Assets</td>
<td>352</td>
<td>318</td>
<td>286</td>
<td>255</td>
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<td>Investments in Associates</td>
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### Cash Flows (Summarized)

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<th>12/14F</th>
<th>12/15F</th>
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<td>Cash Flows from Op Activities</td>
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<td>Increase (Decrease) in Cash</td>
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### Forecasts/Valuations (Summarized)

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<th>12/14F</th>
<th>12/15F</th>
</tr>
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<td>P/E (x)</td>
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<td>P/CF (x)</td>
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<td>P/B (x)</td>
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<td>EV/EBITDA (x)</td>
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<td>EPS (W)</td>
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<td>CFPS (W)</td>
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<td>1,565</td>
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<td>BPS (W)</td>
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<td>10,971</td>
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<td>DPS (W)</td>
<td>80</td>
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Source: Company data, KDB Daewoo Securities Research estimates
Biospace
(041830 KQ)

War against obesity extending to China

Snapshot: No. 1 global supplier of body composition analyzers

Established in 1996, Biospace is the world’s leading supplier of body composition analyzers, well known for its brand InBody. A body composition analyzer is an electronic medical device that uses a micro current to measure water, protein, minerals, and fat, and muscle mass. High-end professional analyzers are mainly used in commercial gyms, schools, government agencies, and clinics. The recently released personal-use analyzer InBody Dial, which allows users to measure their body fat on their smartphones, is likely to gain ground once the ubiquitous healthcare (u-healthcare) market (B2C) enters full-fledged growth.

3Q review: Earnings defy slow season thanks to InBody exports

For 3Q, Biospace posted solid YoY earnings growth, with consolidated revenue of W8.9bn (+14% YoY), operating profit of W2bn (+40% YoY), and net profit of W1.4bn (+15% YoY). Despite 3Q traditionally being the weakest quarter for the company, increased exports to China helped drive solid earnings.

3Q OP margin came in at an impressive 22.2%, boosted by operating leverage effects from revenue growth. Previously, the company had been burdened by significant fixed costs due to R&D spending and participation in exhibitions. Going forward, we forecast SG&A ratio to steadily decline from 57.3% in 2011 to 52.1% in 2013 and 49% in 2014, on the back of export-driven revenue growth. As such, we expect earnings to reach record highs in 2014, with consolidated revenue of W43bn (+17% YoY), operating profit of W9.5bn (+32% YoY), and net profit of W9bn (+32% YoY).

Many countries are waging war against the obesity epidemic. In fact, the global weight loss market has been growing sharply, especially as younger people place an increasing importance on beauty and health. The US market, including exercise equipment, medical devices, diet food, and related drugs, is estimated at US$60bn (W63tr). China’s market has surged 530% from RMB11bn in 2006 to RMB70bn (W1.2tr) in 2012. Around 25% (335mn) of China’s population is considered overweight or obese (as of 2012), pointing to strong potential for growth in the Chinese weight loss market. Biospace boasts a solid brand reputation and technological strength in the body composition analyzer market, and is likely to benefit as obesity becomes a more prominent social issue in China. We estimate the company’s exports to expand at a 28.6% CAGR from 2010 to 2013 (W9.1bn in 2010; W18bn in 2011; W21.8bn in 2012; W25bn in 2014).

Valuation: Undervalued compared to medical device peers

Currently, the stock is trading at 2013F and 2014F P/Es of 16.1x and 12.3x, respectively, below the average 2013F multiple (17.2x) of the medical device sector. We expect earnings to grow forward as the company shifts away from the domestic market and into overseas markets. The release of the consumer-use InBody device should benefit from the expected growth of the u-healthcare market (B2C). As of end-1H13, the company holds W18.8bn in net cash and around W15bn in property (including its Gaepo office building).

Notes: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests
Source: Company data, KDB Daewoo Securities Research estimates
China is a participant in the war against obesity

Many countries are waging war against the obesity epidemic. In fact, the global weight loss market has been growing sharply, especially as younger people place an increasing importance on beauty and health. Biospace boasts a solid brand reputation and technological strength in the body composition analyzer market, and is likely to benefit as obesity becomes a more prominent social issue in China. We estimate the company’s exports (to the US, Japan, and China) will expand at a 28.6% CAGR from 2010 to 2013 (W9.1bn in 2010; W18bn in 2011; W21.8bn in 2012; W25bn in 2014).

In the US, where obesity has long been an issue, weight control is more than a personal issue; it is led by the government on a national level. In February, President Obama established an interdepartmental task force for the study of childhood obesity. First Lady Michelle Obama has also been actively involved in the issue, spearheading an anti-childhood obesity campaign. The US weight loss market, including exercise equipment, medical devices, diet foods, and drugs, is estimated at US$60bn (W63tr). In Japan, dieting has become widespread since the 1970s and is now considered to be a normal part of the Japanese lifestyle. According to a recent online survey, 54 out of 100 Japanese men and 64 out of 100 Japanese women said they were on a diet.

China is a combatant in the war against obesity. According to People’s Daily Online, China’s overweight or obese population reached 335mn, or 25% of the total population, in 2012, up from 15% in 2006. China’s weight loss market has surged 530% from RMB11bn in 2006 to RMB70bn (W1.2tr) in 2012.
Table 1. Annual earnings (based on consolidated K-IFRS) (Wbn, %)

<table>
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<tr>
<th>Division</th>
<th>Domestic/exports</th>
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<th>2012</th>
<th>2013F</th>
<th>2014F</th>
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<td>Revenue</td>
<td>Total</td>
<td>31.6</td>
<td>33.2</td>
<td>36.7</td>
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<td>51.0</td>
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<tr>
<td></td>
<td>Exports</td>
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<td>25.0</td>
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<td></td>
<td>Domestic</td>
<td>13.6</td>
<td>11.5</td>
<td>11.7</td>
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<tr>
<td>YoY growth</td>
<td>Total</td>
<td>-</td>
<td>5</td>
<td>11</td>
<td>17</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>Exports</td>
<td>-</td>
<td>21</td>
<td>15</td>
<td>22</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Domestic</td>
<td>-</td>
<td>-16</td>
<td>2</td>
<td>7</td>
<td>12</td>
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<tr>
<td>Operating profit</td>
<td>3.9</td>
<td>5.0</td>
<td>7.2</td>
<td>9.5</td>
<td>12.0</td>
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<tr>
<td>YoY growth</td>
<td>30.0</td>
<td>44.0</td>
<td>51.0</td>
<td>57.0</td>
<td>63.0</td>
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<tr>
<td>Pretax profit</td>
<td>5.9</td>
<td>6.0</td>
<td>7.7</td>
<td>10.2</td>
<td>12.9</td>
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<tr>
<td>Net profit attributable to controlling interests</td>
<td>5.5</td>
<td>5.6</td>
<td>6.8</td>
<td>9.0</td>
<td>11.5</td>
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<tr>
<td>YoY growth</td>
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<td>2</td>
<td>21</td>
<td>32</td>
<td>27</td>
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<tr>
<td>OP margin</td>
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<td>19.6</td>
<td>22.0</td>
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<td>Net margin</td>
<td>17.5</td>
<td>17.0</td>
<td>18.6</td>
<td>21.0</td>
<td>22.5</td>
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Source: Company data, KDB Daewoo Securities Research

Table 2. Quarterly earnings (based on consolidated K-IFRS) (Wbn, %)

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<tr>
<th></th>
<th>2012</th>
<th>2013F</th>
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<td>3Q</td>
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<tr>
<td>QoQ growth</td>
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<td>-9</td>
<td>6</td>
<td>-</td>
<td>7</td>
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<tr>
<td>YoY growth</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6</td>
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<tr>
<td>Operating profit</td>
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<td>1.2</td>
<td>1.4</td>
<td>0.4</td>
<td>2.5</td>
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<td>QoQ growth</td>
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<td>18</td>
<td>-74</td>
<td>583</td>
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<tr>
<td>YoY growth</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>23</td>
</tr>
<tr>
<td>Pretax profit</td>
<td>2.4</td>
<td>1.5</td>
<td>1.0</td>
<td>1.1</td>
<td>2.7</td>
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<tr>
<td>Net profit attributable to controlling interests</td>
<td>2.3</td>
<td>1.1</td>
<td>1.2</td>
<td>1.0</td>
<td>2.5</td>
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<tr>
<td>QoQ growth</td>
<td>-</td>
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<td>YoY growth</td>
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<td>OP margin</td>
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<td>18.0</td>
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<td>11.8</td>
<td>28.1</td>
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</table>

Source: Company data, KDB Daewoo Securities Research

Figure 5. Earnings forecasts (based on consolidated K-IFRS)  Figure 6. Net cash: -18.8Wbn as of end-1H13 (based on consolidated K-IFRS)

Source: Company data, KDB Daewoo Securities Research  Source: Company data, KDB Daewoo Securities Research
Figure 7. Commercial-use InBody analyzers

Figure 8. Personal-use body InBody analyzer

Figure 9. Accurate measurements (margin of error: less than 1%)

Figure 10. Export-led growth began this year

Figure 11. Export proportion of 68% (2013F)

Figure 12. 2012 revenue breakdown by region (based on consolidated K-IFRS)
### Biospace (041830 KQ/Not Rated)

#### Comprehensive Income Statement (Summarized)

<table>
<thead>
<tr>
<th></th>
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<th>12/13F</th>
<th>12/14F</th>
<th>12/15F</th>
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<tr>
<td><strong>Revenue</strong></td>
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<td><strong>Gross Profit</strong></td>
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<td><strong>SG&amp;A Expenses</strong></td>
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<td>12</td>
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<tr>
<td><strong>Operating Profit</strong></td>
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<td><strong>Non-Operating Profit</strong></td>
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<td><strong>Profit from Continuing Operations</strong></td>
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<td>12</td>
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<td><strong>Controlling Interests</strong></td>
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<td>9</td>
<td>12</td>
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<tr>
<td><strong>Non-Controlling Interests</strong></td>
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<tr>
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<tr>
<td><strong>FCF (Free Cash Flow)</strong></td>
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<td>11</td>
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<td><strong>EBITDA Margin (%)</strong></td>
<td>16.8</td>
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<td>25.3</td>
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<tr>
<td><strong>Operating Profit Margin (%)</strong></td>
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#### Statement of Financial Condition (Summarized)

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#### Cash Flows (Summarized)

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#### Forecasts/Valuations (Summarized)

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Kleannara
(004540 KS)

Bullish on China, but overhang risk remains

Snapshot: The only home-grown comprehensive paper product supplier
Established in 1966 as a maker of liners, Kleannara first expanded its business scope by producing white board for use in paper cups, snack boxes and cosmetics packaging. Since then, the company has grown into a comprehensive paper product manufacturer by adding personal care products to its portfolio through M&As. Along with a few other players, Kleannara (25% market share) dominates the domestic white board market. The company has a diverse personal care portfolio that includes toilet paper, facial tissue, wet wipes, diapers, and feminine hygiene products. By division, the paper business accounts for 53% of revenue and personal care 47% (as of 2012).

Catalysts: Personal care exports to boost earnings
The paper business has been slowing since 4Q12 due to sluggish economic conditions, and has shown a continuous decline in scrap paper prices. Although paper earnings should pick up in 2H13, we still expect negative growth on an annualized basis for 2013. Therefore, we project only modest total growth for this year, despite a sharp increase in personal care revenue.

Looking ahead into 2014, we forecast top-line growth to improve to around 5% on the back of personal care exports and better paper earnings. In contrast to the paper business, for which exports account for half of sales, the personal care business has traditionally been focused on the domestic market. Beginning this year, however, the company has been boosting exports of its consumer care products to the rest of Asia. We are particularly upbeat on the exports of the firm’s Bosomi diapers to China.

In order to enter China’s premium diaper market with Bosomi, Kleannara signed an MOU with Lock & Lock, which has an extensive distribution network in the country. Initially, the company plans to sell its diapers in Lock & Lock stores and some 1,800 specialty retailers in the country, before gradually expanding into large discount stores, online websites, and home shopping channels. The first shipments were made in August of this year, and sales began smoothly in November. We estimate Chinese revenue to grow from W4bn in 2013 to around W12-15bn in 2014.

As recently as the early 2000’s, almost all Chinese parents used cloth diapers. However, disposable diapers have become more widespread, with the penetration rate now standing at 30%. China’s diaper market is estimated at W6tr (five times the size of Korea’s) and the usage rate is expected to more than double in the next decade. Many Chinese parents prefer foreign brands over local brands despite their higher prices because of hygiene concerns. Demand for Japanese diapers, however, has recently been shrinking in response to radiation fears. The easing of the Chinese government’s one-child policy is also supportive to the business environment.

Valuation & risks: Optimistic on earnings growth, but overhang risk remains
For 2014, we forecast non-consolidated revenue and operating profit to grow to W673.3bn (+5% YoY) and W23.9bn (+14% YoY), driven by increasing personal care exports. However, the potential overhang from the company’s bonds with warrants (250,000 shares) and convertible bonds (9.5mn shares or 28% of total common shares outstanding) poses a risk to the stock’s valuation.
Product lineups for paper and personal care

Figure 1. Toilet paper accounts for 60% of personal care revenue

Source: Company materials

Figure 2. Sanitary products account for 40% of personal care revenue

Source: Company materials

Figure 3. Paper products: Mostly used in packaging

Source: Company materials
Earnings trends and outlook

Table 1. Annual earnings and forecasts (Wbn, %)

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<td>-10.9</td>
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Source: Company data, KDB Daewoo Securities Research

Figure 4. Gradual increase in proportion of personal care…
Figure 5. …to lead to profitability improvement

Table 2. Overhang risk details (W, '000 shares, %)

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<thead>
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<th>Types</th>
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<th>Conversion period</th>
<th>Conversion price</th>
<th>Shares available for conversion</th>
<th>% of overall common shares</th>
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<td>6/17/39</td>
<td>W50bn</td>
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Source: Company data, KDB Daewoo Securities Research
China’s diaper market

In China, the one-child policy (introduced in 1979) has given rise to increasing consumer spending driven by the so-called little emperors born during the 1980s and 1990s. Now that the Chinese government has relaxed its family planning policy, the Chinese baby care market is expected to grow at a faster pace.

In particular, the country’s diaper market is likely to see steady growth in the coming years, as diapers are a basic necessity for babies up to 36 months. In China, around 20-30mn infants are born every year, and there are currently 40-50mn babies under 36 months old.

Market size and competitive landscape

Many Chinese consumers used cloth diapers as recently as 2000, when the penetration rate of disposable diapers was just 2%. Disposable diapers have become more widespread since then. The penetration rate has risen to 30% and is projected to double to 60% by 2020, led by consumers in major cities. China’s disposable diaper consumption grew at a CAGR of roughly 30% from 2007 to 2010, and total sales were estimated to be RMB24.3bn (W4.2tr) in 2011. The country’s diaper imports, which totaled US$183mn (+17% YoY) in 2011, have been increasing at a rapid pace every year. Imports of Korean brand diapers increased to US$91mn, up more than 5% YoY.

China’s diaper market is heavily concentrated, with the top ten brands controlling 70% of the market. Seven of them are foreign brands, with premium brands like Pampers (Procter & Gamble), Huggies (Yuhan-Kimberly), Merries (Japan’s Kao) and MamyPoko (Japan’s Unicharm) holding high ranks. Chinese consumers tend to avoid local brands (despite their low prices) because of their lack of absorbency, perceived tendency to cause rashes, and hygiene issues. Recently, demand for Japanese brands has been steadily shrinking due to radiation fears, which should help advance Korean brands in the Chinese market.

Table 3. Market trends and forecasts of Chinese infant paper diapers ('000 persons, mn pieces, %)

<table>
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<th>Year</th>
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Source: KOTRA, KDB Daewoo Securities Research

Figure 6. China’s diaper import trends

Source: KOTRA, KDB Daewoo Securities Research
## Comprehensive Income Statement (Summarized)

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## Statement of Financial Condition (Summarized)

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## Cash Flows (Summarized)

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## Forecasts/Valuations (Summarized)

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<td>Liability to Equity Ratio (%)</td>
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<td>Current Ratio (%)</td>
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<td>Net Debt to Equity Ratio (%)</td>
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<td>Interest Coverage Ratio (x)</td>
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Source: Company data, KDB Daewoo Securities Research estimates
China holds the key

Pace of powdered milk growth in China will be key

Renewed attention on the safety of powdered milk in China has bolstered the outlook for Korean formula exports to the country. In 2012, exports surged 62.5% YoY to US$39mn from US$24mn in 2011. For 2013, export growth is projected to continue to exceed 60% YoY. We estimate China’s powdered market at W10tr, of which 70% is controlled by foreign brands. Korean brands still account for just 2-3% of the Chinese market.

The three largest powdered milk makers in Korea all export to China, but Maeil Dairy is the only one to export powdered milk under its own brand name (Absolute Myung-Jak). We forecast Maeil’s powdered milk exports to China to grow from W14bn in 2012 to W30bn in 2013 and W50bn in 2015. We estimate OP margin to be around 10-15%.

In China, Maeil’s powdered milk is distributed by a local dealer and is sold in 3,800 stores (up from 3,000 in 2012 and 2,400 in 2011), mostly in second- and third-tier cities. Korean brands are already recognized for their high quality and competitive prices, so the key to success will eventually lie in the expansion of distribution networks. Maeil is looking to tap into Lock & Lock’s Chinese retail network (57 directly-operated stores and 28 franchise stores) to expand its local presence and also plans to launch a Chinese website (together with Zero to Seven) in response to the rising prominence of online channels.

Over the long term, the company may consider forging agreements with multiple dealers in order to advance into large discount stores in first-tier cities. In this case, the company will obviously need to be careful not to cause friction with its existing dealer.

Recently, some foreign brands in China slashed the prices of high-end powdered milk products (or provided free gifts). However, we do not expect Maeil (a mid-level brand) to follow suit.

Milk price hikes and expansion into coffee and cheese markets

Maeil’s annual raw milk purchases are estimated at W250bn. As such, the recent 12.5% hike in raw milk prices has led to a W30bn increase in costs. In response, the company has raised the prices of its white milk, processed milk, and pasteurized milk by an average of 8-9%. Although the price hikes are just enough to offset the rise in costs, we still expect some profit gains, due to the fact that the price increases vary by item. The company has been expanding its business areas to include coffee and cheese. The domestic coffee market has continued to show annual growth of over 10%, and the domestic cheese market is also expanding 15-20% per year, spurred by the increased popularity of western F&B items such as wine and pasta.

Maintain Buy and TP of W50,000

We maintain our Buy rating and target price of W50,000 for Maeil Dairy. We expect the company’s growth to be spurred by: 1) dairy price hikes, 2) exports to China, and 3) the business diversification of affiliates. In deriving our target price, we applied a 30% premium to the average P/E (16x) of the F&B sector in light of the growth prospects of powdered milk in China.
Figure 1. Dairy product price hikes to be reflected in 2014

![Graph showing CPI for milk and yogurt from 2001 to 2013.](source: Statistics Korea, KDB Daewoo Securities Research)

Figure 2. Domestic powdered milk shipments have declined in 2013

![Graph showing shipments and YoY growth of powdered milk from 2010 to 2013.](source: Statistics Korea, KDB Daewoo Securities Research)

Figure 3. China's powdered milk market growing 10% annually

![Graph showing market size and YoY growth from 2007 to 2015.](source: Euromonitor, KDB Daewoo Securities Research)

Figure 4. Korean brands control a relatively small proportion of the Chinese powdered milk market

![Pie chart showing market share of various brands.](source: Media report, KDB Daewoo Securities Research)

Figure 5. Maeil's powdered milk exports to China growing

![Graph showing monthly exports of powdered milk to China from 2005 to 2013.](source: Company data, KDB Daewoo Securities Research)

Figure 6. Korea's powdered milk exports to China growing

![Graph showing monthly exports of powdered milk to China from 2005 to 2013.](source: KITA, KDB Daewoo Securities Research)
Maeil Dairy (005990 KQ/Buy)

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### Statement of Financial Condition (Summarized)

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### Cash Flows (Summarized)

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Source: Company data, KDB Daewoo Securities Research estimates

### Forecasts/Valuations (Summarized)

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Source: Company data, KDB Daewoo Securities Research estimates
Zero to Seven
(159580 KQ)

A long-term growth play

Overview: Leading children’s wear producer with high overseas growth potential

Established in 2000 as a customer service provider to Maeil Dairy, Zero to Seven has become one of the leading children's wear makers in Korea. The company has continuously expanded its children's apparel business since the 2004 launch of the mid-to-low-end brand Allo & Lugh, and now holds the largest share (15-16%) of the baby/kids wear market among domestic brands.

Korea's children's wear market accounts for 5% of the overall apparel market, and has stagnated over the years due to falling birth rates. In response, the company established a Chinese subsidiary in 2007, which has driven the company's turnaround since 2009. As of 2012, the company derived 46.5% of its revenue from apparel, 31.1% from distribution, and 7.7% from China.

Long-term catalysts: Growth of China’s children’s product market

In 2013, we estimate China will contribute just 10.2% to overall revenue, but a whopping 52% to overall operating profit. This is largely because the Chinese business boasts higher profitability than the rest of the company’s operations. Unlike in Korea, Zero to Seven is positioned as a premium company in China and imposes a no-discount policy in the country to protect its brand image. The company’s Chinese earnings are all the more important in light of the continued losses at its lagging domestic apparel business and distribution unit (which handles the sales of children’s products and foreign brands).

Recent moves by the Chinese government to ease its one-child policy are also raising expectations for the Chinese market as well as for Zero to Seven’s Chinese growth. The company has secured the Chinese distribution rights for the UK nursery brand Mamas & Papas until 2015 and plans to aggressively expand the number of stores in the country. Although such investments mean earnings are unlikely to pick up in the near term, we believe it is an essential step to ensure growth over the medium to long term. In addition to the distribution of foreign brands, the company is also set to launch its own brand Skarbarn in China. All in all, we believe the company merits a premium for its strong growth potential in China.

Weak 2013 earnings expected, but ample room for long-term growth still exists

Zero to Seven has posted weaker-than-expected earnings in 2013, mainly due to the negative YoY growth of the domestic apparel business, which still accounts for 51% of overall revenue. And the distribution business has also been hit by Japanese radiation fears, which have dragged down diaper sales of the Japanese brand Goon (22% of overall distribution revenue).

In the near term, the stock’s valuation has become less appealing due to a combination of short-term earnings deterioration and increasing costs. However, we expect the brand Mamas & Papas to begin meaningful growth in China in 2H14, which should bring attention to the company as an attractive long-term growth play.
Figure 18. China’s annual population changes

Source: PBOC, CEIC, KDB Daewoo Securities Research

Figure 19. Number of newborns in China per year

Source: PBOC, CEIC, KDB Daewoo Securities Research

Figure 20. Chinese revenue by brand

Source: Company data, KDB Daewoo Securities Research

Figure 21. Profitability likely to slow due to continued investment

Source: Company data, KDB Daewoo Securities Research

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Source: Company data, KDB Daewoo Securities Research
### Comprehensive Income Statement (Summarized)

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### Statement of Financial Condition (Summarized)

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### Cash Flows (Summarized)

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### Forecasts/Valuations (Summarized)

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Source: Company data, KDB Daewoo Securities Research estimates
APPENDIX 1

Important Disclosures & Disclaimers

Disclosures
As of the publication date, Daewoo Securities Co., Ltd and/or its affiliates do not have any special interest with the subject company and do not own 1% or more of the subject company’s shares outstanding.

Stock Ratings

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* Ratings and Target Price History (Share price (----), Target price (----), Not covered (III), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))
* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.
* Although it is not part of the official ratings at Daewoo Securities, we may call a trading opportunity in case there is a technical or short-term material development.
* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst’s estimate of future earnings. The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

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